THE ECONOMIC IMPACT OF CANADA'S RETIREMENT INCOME SYSTEM

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FOREWORD

The Writings in Gerontology series is intended as a vehicle for sharing, with interested Canadians and the public generally, ideas and points of view -- if not contentious issues -- which prevail and may affect the status of elderly persons today and tomorrow.

Texts presented in this series may be adapted or rewritten from original works in order to facilitate comprehension; they may also simply be reprinted for wider circulation. Publications of an article or paper signifies that it is deemed to contain material worthy of public consideration, but does not imply endorsement of conclusions or recommendations by the National Advisory Council on Aging. Such action is part of the Council's role in stimulating discussion and disseminating information on aging.

It is hoped that readers will find the Writings of value for their own pursuits. Also, the Council would welcome comments on the topics selected as well as on the papers themselves.

Maurice Miron, Director
National Advisory Council on Aging

PREFACE

The impact of Canada's aging population is being felt everywhere. The problems presented by this impact, which in most cases are certainly not new, are nevertheless taking on far greater proportions. A matter of considerable concern has to do with the economic impact of the nation's current arrangements for retirement income. Then, there are the challenges of adequate housing, of health care and of a host of support programs.

These and other aspects of the aging process were considered at a recent conference sponsored by the Gerontology Research Council of Ontario. A number of commendable papers by experts were presented and subsequently published under the title "Research Issues in Aging", copies of which are available at $4.50 from the Council: 88 Maplewood Avenue, Hamilton, Ontario, L8M 1W9. The material in this booklet is based on one of these published papers, i.e. the text by Keith Patterson of the Economic Council of Canada. The National Advisory Council on Aging is indebted to the Gerontology Research Council of Ontario for the use of its material.

1. INTRODUCTION

In 1979 the Economic Council of Canada published a three-year study[1] on the long-term impact on the economy of Canada's retirement income system. Its major conclusion was perhaps surprising -- that Canada can provide adequate retirement income for its older population without harm to the economy. This is a particularly important conclusion since it has been reported quite regularly in the media that the present system is too "rich" and is heading for trouble. There are charges, for example, that the Canada Pension Plan and the Quebec Pension Plan (CPP/QPP) are going broke. There have been numerous statements insisting that full indexing of pensions would place an unbearable strain on the economy. But there have also been calls for the provision of increased benefits and services which could threaten what the economy might be able to support in the future. These were the charges and counter charges when the study was first begun. However, as Keith Patterson pointed out, now that many of these myths have been laid to rest by the Council's authoritative report, the way should now be open for rational planning to assure that those in need will be taken care of more adequately in the future. The focus and purpose of this paper is to assess the Council's report in relation to Canada's current retirement income program.

2. REPORT OF THE ECONOMIC COUNCIL OF CANADA ON PENSIONS

2A. A Systems Approach

The Council's report is first and foremost an economic analysis. It focuses on the long-term implications for the economy of Canada's system of income security for older people. It looks at the costs of the system in terms of the proportion of Canada's Gross National Product (GNP), i.e. the total output in any one year of all the country's goods and services, that might be required under various population age distributions and policy options. It looks, too, at the potential costs of the system in terms of other national objectives, especially economic growth.

The report looks at the "ball park" in which this system will operate in the future. It is designed, in this sense, to complement other major studies of the subject, including the reports of the Task Force on Retirement Income Policy[2] and the Royal Commission on the Status of Pensions in Ontario.[3] It is also designed to clarify the many misconceptions, misunderstandings and fears about Canada's retirement income policies.

There are good reasons why some of the Council's conclusions will differ from commonly held positions of recent years. For one reason, this is the first study in this country that examines retirement policies as part of a demographic-economic system, that is, from the point of view of how the population density and capacity to expand or decline is related to the economy. Second, the report considers various policy alternatives in relation to clearly expressed objectives.

As Patterson points out, the results of examining retirement policies in isolation can be very misleading. Changes in the age structure of the population, or in policies designed to provide income for older people, can affect the economy in two ways. They can alter the claims made by older people on the economy's total output of goods and services (GNP). But they can also affect the economy's capacity for supplying those goods and services, that is, the growth and level of GNP. The report involves continuous reference to a comprehensive framework within which both sets of effects can be examined. For example, in projecting the share of GNP that would be required for the older population in the future, the report provides estimates that take into account not only the impact of the growing number of older people and the level of pension benefits in the demand for

goods and services, but at the same time, the effect on the GNP of a much more slowly growing labour force. Furthermore, it indicates what additional effects the retirement income system itself might have on the GNP by way of its impact on savings and capital formation, on the one hand, and the supply of labour on the other.

Failure to use this "systems" approach is not the only reason for some of the wide-ranging differences in opinions on the subject. Frequently, these differences reflect varied opinions about the possible goals of the system of income security for the old. Frequently too, those goals are only implied in discussions, if not actually hidden. Policy changes are suggested on the basis of their implications for economic growth, for the balance of payments, and for the level of foreign ownership of Canadian industry.

The Council's report does not deny the importance of some of these other goals. In fact, it goes to some length to show how particular policy choices may affect them. It suggests that the primary objectives of the system of income security for the old are: first, the provision of a basic, or floor, income regardless of an individual's previous circumstances; and second, the provision of some level of income replacement that would prevent an unduly large fall in the

standard of living of individuals between their prime and later years. If the question of the impact of a policy change on these objectives can't be answered, then there is something wrong. The report discusses the shortcomings of the present system in relation to these primary objectives and discusses a variety of ways in which they might be achieved in the future.

The report stresses the fact that, even with present retirement benefit levels, the proportion of total goods and services required for our elderly population will increase. That proportion will increase even further if action is taken to remove the existing gaps in the system. The report sets out the required proportions in easy-to-compare numbers; it also shows how sensitive these numbers can be to demographic and policy changes. This, of course, is not new. But what is new is the insight this provides on the ways in which the challenge of improving benefits for a substantially increased older population can be met.

2B. Conclusions of the Council's Report

The report of the Council's study did not suggest any simple, sweeping or magical conclusions. It admitted openly that, although many areas of disagreement had been greatly narrowed, individual Council members continued to differ about the relative importance of some goals and the ways in which, or the speed with which, the obvious shortcomings of the system should be removed. Nevertheless, the recommendations, some 15 in all, do emphasize the general direction in which the system will have to move. In particular, they reflect the need for flexibility and for keeping options open in the face of uncertain demographic trends; the need to keep a close eye on the sharing of the "pension burden" between present and future workers; and finally, the need for substantial government-industry cooperation at the very least.

The first five recommendations, for example, propose more explicit recognition by the federal government of the poverty-prevention role of the basic income programs, and a flexible method for upgrading those programs as demographic and economic trends unfold.

Recommendations 6 to 14 suggest ways in which Canada's income-replacement programs for the old should move, especially CPP/QPP and employer-sponsored plans. The Council did not recommend immediate full funding of the present public schemes but proposed increases in contribution rates, beginning in the 1980s. And it suggested that any further substantial increases in public pension benefits will require much greater advance fundings.

The report recommended a number of ways to improve the private system, including: the provision of more information for participants in the plan; greater standardization of the various pension benefits Acts; and some easing of investment constraints. Most important, it suggested the provision of an indexed annuity for pension plans by the federal government, subject to certain qualifying conditions. Such an instrument could help to both ease fears about an open-ended commitment for private employers, and to bring plans for public and private employees more into line with respect to inflation protection. The report also recommended bringing the use of funds in government-employee pension plans more into line with practice in trusteed and insured plans.

3. THE RETIREMENT INCOME SYSTEM IN CANADA

3A. Gaps

Patterson points to some glaring gaps in the current Canadian system. He emphasizes that no amount of reference to how much it has improved, or to how well some people can do under it, or to how good some private-employer plans are -- none of these qualifiers, he insists, can hide the obvious gaps. The bare fact is that, while the system has progressed, many within it have been left behind.

Consider the following:

- Despite the upgrading of Canada's basic income programs in recent years, in 1977, according to Statistics Canada, 60% of unattached Canadians over age 65 -- more than half a million people, many of them elderly women -- were below the poverty line! (Other calculations of the poverty line put even more people in this category.)

- Although CPP/QPP cover almost all of the work force, some groups, and particularly housewives, are excluded. And not only that, many CPP/QPP retirement payments fall below the maximum.

- There is even a greater number of benefit problems related to employer-sponsored pension plans. Less than half of our paid workers are covered; and coverage is very uneven and particularly low in small private firms and within the retail trade. Moreover, the chances for workers who change jobs to build up even a fraction of the maximum benefits paid to the long-time employees are very small indeed. Finally, only a third of private-employer plans provide widow's pensions, and there are many other disparities as between the treatment of men and women.

- Protection against the ravages of inflation is obviously inadequate. Not only do fixed benefits erode future retirement payments, but post-retirement protection in particular is either insufficient or based on an employer's particular decision -- certainly an unsound basis for financial planning by pensioners.

- Finally, measured by international standards, Canada ranks low in the percentage of preretired earnings which future pensioners have to replace by public income security plans. This is particularly so for single people.

3B. Estimating the Future Population

The average age of Canada's population is increasing so that in the future there will be greatly increased numbers of older people, particularly women aged 75 and over.

It is possible to quite accurately predict the numbers of older people as far ahead as the year 2030 -- they are alive now and their future numbers will be affected only by migration and death. However, it is much more difficult to predict the size of younger age groups, or those of work-force age (20-64), or those who will actually be working at any given time. Such predictions must depend upon fertility and birth rates, which can produce rapid population shifts. Predictions also depend upon the changing degrees of interest by the population to participate in the work force. It was for this reason that the Council's study used a range of population and work-force projections.

These projections indicated a future sharp increase in the numbers of older people relative to the working age population. It was shown that, by the time today's high school students reach the age of retirement, approximately one out of every five Canadians will be 65 or more, as compared roughly with one out of ten today. Even more important, in terms of its economic implications, there will be a sharp increase of those 65 or over relative to those of work-force age. That shift is more pronounced if a slower population growth is assumed. In fact, the proportion of elderly people (65+) among the population now aged 20 or over could, in the next 50 years, jump from about one-in-seven to nearly one-in-three -- a circumstance which suggested the title of the Council's report.

3C. Estimating Future Expenditures

Economists tend to think of the GNP of a country as having a sort of budget. Expressed in these terms, unless Canada borrows continuously from other countries -- and that can raise all sorts of problems after awhile -- that total represents what is available at any one time to provide all the goods and services that are consumed, as well as the investment required to increase future production.

As time goes on, for example, more and more people will be leaving the labour force because of their age, and there will be fewer and fewer young people to replace them. The task of providing the food, shelter, clothing, etc., for those older people will come to rest on the shoulders of a work force that is increasing much more slowly. This could present serious implications for future costs.

Benefits paid under the major public retirement plans of CPP/QPP, together with OAS/GIS (Old Age Security and Guaranteed Income Supplement), now absorb about 3% of Canada's total output of goods and services. By maintaining current benefit levels (though with OAS/GIS payments allowed to rise in line with real wages) and the present age of eligibility at 65, the 3% would then increase to 7% by 2031. This assumes Medium population growth projection so that the greatest increases would occur during the years 2010-2030. Also, using the Low population growth estimate, the proportion would increase to 10%, a percentage very similar to many European countries today. But, considering the gaps in the present system, it would be surprising if Canadians were not prepared to accept some additional increases in cost in order to improve benefits.

If present benefit levels were to be maintained, but the age eligibility dropped from 65 to 60, the required proportion could vary from 10% of GNP under High demographic growth to 14% under Low demographic growth. But if instead, the same age eligibility of 65 were maintained, but double the proportion of preretirement income were replaced by CPP/QPP (remembering that, unlike employer-sponsored plans, they cover nearly all of the labour force), then the proportion of GNP required in the economy to support older people could rise as high as 17% under Low demographic growth. Of course, if the proportion of income replacement was increased and the age of eligibility lowered at the same time, the required proportion would rise still higher.

In the past, because of the growth in the economy, it has been possible to absorb more easily the rising levels of health and education expenditures. But retirement income payments are quite a different matter; they are already linked closely to the growth of the economy, and to rising real wages. As GNP grows more rapidly, they grow more rapidly; the share going to older people really varies significantly only according to variations in the numbers of those in the work force and in the level of benefits.

What these figures suggest is, not that the economy will break down under the impact of changing age structure and improved retirement policies, but rather that some hard choices and prudent planning will have to be faced.

It is often suggested that productivity improvements in the economy can be counted on to reduce the share of GNP needed for future pensions, thereby easing their burden on the economy. But in actual fact, the share of GNP going to pensions is not affected much by productivity growth. Increases in productivity are generally reflected in increased wages, and in a very large segment of the pension system -- CPP/QPP and most employer plans, for example -- pensions paid at the time of retirement are determined by wage levels at that time, or very close to that time. Up until now, periodic increases in OAS/GIS benefits have kept the support level of these programs in line with increases in average wages. In the future, however, unless these support levels are increased in line with increased real wages, the relative position of the elderly poor will decline. Indeed, there is pressure in some quarters to have OAS/GIS tied directly to average wages. The Canadian Labour Congress recommended this in 1980 in their brief to the Royal Commission on the Status of Pensions in Ontario.[4]

4. CONCLUSION

Further Research Needed

In his paper referred to earlier, Patterson indicated some areas in which further research is needed. Although not usually thought of as a subject of research on aging, the fertility rate is of considerable importance in determining an economy's capacity to care for an older population. Yet very little is known about what determines this rate.

The Council's report focussed on the provision of retirement income for the elderly. For the "old-old", however, it may be better to provide more by the way of services and less in the form of money income. More research is needed on the sort of goods and services that will need to be provided "in-kind", and what will be the best division between these goods and services, and money income.

Although some research has been done on the effects of aging on job performance and work capacity, much more is needed. Of particular interest are the effects of age on individual productivity, and the extent to which job experience and training offset any physiological decline. It is often argued that the introduction of new technologies and

the expansion of knowledge in an occupation tends to render obsolete some portion of the older worker's accumulated skills and knowledge. This vintage effect eliminates much of the value of the experience of senior, relative to younger, workers.

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